{ Myth or Reality? }

While we work very closely with our supply chain partners, including CIAA, **we wish to correct a number of statements made in their report** "Supporting the competitiveness of the European food and drink industry: **CIAA Competitiveness Report 2010".**

IMPORTANCE OF THE FOOD SUPPLY CHAIN:

Ensuring an adequate, sustainable supply of good food for all consumers – all EU citizens - is of paramount importance. From the farmers who produce the fresh food and raw materials, to the food processors and manufacturers who convert those raw materials to more complex products, to the packaging, transportation, refrigeration, logistics firms who provide necessary services, to the distribution and retail sectors who ensure widespread access and availability of the finished products – the food supply chain is incredibly important to Europe from an economic and employment standpoint. Between them, farmers, the food processing industry and food retailers account for 5% of European value-added and 7% of all employment.

IMPORTANCE OF STAKEHOLDER DISCUSSIONS:

Like any other developed supply chain, the food supply chain broadly works… Like any other, there are competitive pressures within the chain… Like any other, there is need for debate and discussion about how to make the food supply chain more efficient.

IMPORTANCE OF RELIABLE FACTS:

Given the strategic and economic importance of the food chain, it is therefore vital that any discussions – especially those that may lead to future policy decisions – be based on sound, assured, accurate evidence, data and research.

It is equally important that any misleading information be corrected.

The Food Supply Chain
Separating Myth from Reality

MYTH: Small industry vs. huge retail?
REALITY: There are even more SME retailers than SME producers…

The CIAA report might lead the unwary reader to believe that European food and drink manufacturers are all small and weak, while retailers are all huge and powerful. Selective figures are quoted, yet many interesting data about the structure of the retail sector and the size of the largest manufacturers are mysteriously omitted.

3.1 Food supply chain

FUNCTIONING OF THE FOOD CHAIN: Uneven [illegible] relations within the food chain leading to the proliferation of unfair practices

Concentrated retail sector and unequal bargaining power

The food supply chain has a unique and complex structure, which includes a very fragmented market for input producers (with 14.5 million farmers and 310,000[1] food and drink companies in the EU) and a very concentrated market of large retailers.

CIAA 2010 REPORT

'310,000 food and drink companies and a very concentrated market of large retailers'… Was it not worth mentioning in this context the 487,272 food retail outlets across the EU [SEC(2010) 807]? Probably not – that may have made it look as if the food and drink industry is more concentrated than the retail sector!

{ The truth is that in both the food industry and the food retail sectors the vast majority of operators are small and medium sized companies. }

Myth: 14.5m farmers deal directly with a few large retailers… **REALITY: A multitude of intermediaries are in-between…**

Producers are the least concentrated sector in the food supply chain, which leaves them at a comparative disadvantage in terms of bargaining power. Non-processed food suppliers are often unable to build a critical mass in terms of volumes and lack an efficient and speedy delivery infrastructure… Due to this fragmented structure and low efficiency in their marketing operations, farmers are often unable to enter into more direct negotiations with their retail counterparts. The agricultural produce is thus, in many cases, purchased and re-sold by a number of intermediaries before it can reach shop shelves.

Retail would say that, wouldn't we? However, these are the words of the Commission after a year-long analysis of competition along the food supply chain [SEC(2009) 1449/2]. That report said the following concerning the processed food sector: "The food industry is more concentrated than agricultural suppliers, especially if large industrial multinationals are considered."

The European Parliament report on fair revenues for farmers [2009/2237(INI)] noted… "that in some countries the food processing industry has the largest margin in the food chain, as has also been confirmed by the Commission; calls for the processing industry in particular therefore to be monitored and investigated in order to guarantee price transparency."

{ In general, it is the food and drink manufacturers who negotiate terms and prices with farmers, not retailers. }

MYTH: Retail concentration = unequal bargaining power… **REALITY: Industry concentrated much earlier, and bargaining is not all about size…**

Readers should treat claims about unequal bargaining power with more than a grain of salt. In effect, the structure of the retail sector has recently become more like the structure of food industry. Retail is catching up. While the vast majority of companies in both parts of the supply chain are SMEs, both parts have a small number of strong, larger operators. Here is part of what the Commission says about retailers and industry [SEC(2009) 1449/2]:

Proliferation of unfair practices in the food chain to the detriment of the food industry and consumers

The difference in bargaining [illegible] the food chain has led to the [illegible] manifestly unfair commercial practices[6]. As a result, food and drink companies have a lower capacity to invest

5 99.1% of EU food and drink companies are SMEs, of which small companies provide 15.2% of the sector's turnover and medium companies provide 26.9% of turnover. Large companies account for 0.9% of number of companies, but provide 51.3% of turnover.

6 For example, retrospective changes to the contract, long and late payments, demand for undue contributions, etc.

CIAA 2010 REPORT

"When negotiations occur between retailers and large multinational suppliers, who are often producers of a portfolio of goods which are in some cases must-carry* brands, suppliers may have significant market power. In such cases, the buyer power of even the largest retailers may be offset by the market power of the suppliers. The profit margins of such "unavoidable" suppliers are generally higher than those of retailers… Furthermore, in the processed food and drinks industry, concentration has occurred earlier and some of the leading brands are supplied by a very small number of producers."

* ('must-carry' brands: where consumer demand for a particular brand is so strong that retailers have no choice but to stock and sell the product)

The 2008 UK Competition Commission report into the national grocery sector stated: "…the exercise of buyer power by grocery retailers is likely to have positive implications for consumers... It may also act as a countervailing force to any market power possessed by suppliers and can spur innovation in the supply chain."

Of course, there may be unequal bargaining power between some large retailers and small suppliers. However, many large suppliers may also have unequal bargaining power over small farmer suppliers and small retail customers. The economic independence of each operator, not size, is the most important factor.

{ Frequently, bargaining power is not related to size: many other issues can also influence the negotiations between two parties – level of demand for the product, scarcity of supply, division of market areas by food suppliers, strong brand awareness, etc. All play a part, leading to the situation where even the biggest may find themselves at a disadvantage vis a vis smaller supply chain partners. }

CIAA lists a number of what they consider unfair retail practices. In the interests of balance, it would have been useful if they could also have added the following examples of unfair selling power to their list:

- Food/drink suppliers who impose artificial territorial constraints on retailers buying their products, thereby denying retailers the possibility of aggregating purchases at lower prices;
- Food/drink suppliers who tie the sale of less popular products to 'must-have' products in their portfolios;
- Food/drink suppliers who deliver late, or not at all, or with reduced quantities than those ordered...

MYTH: Retailers' own labels are bad for consumers… **REALITY: Own brands offer valuable competition and consumers clearly love them!**

PRIVATE LABELS: The dual role of retailers and the misuse of Private Labels

Facts: The increase in Private Labels (PL) gives rise to a series of issues, of which the 'dual agent' role where the retailer is both the customer and competitor is one of the most critical. Various negative effects can be seen, such as the effect on consumer choice and on prices, which are already evident today. Intra-brand and in-store competition are also hampered, which triggers similar concerns.

CIAA 2010 REPORT

CIAA are right to point out that an increasing number of consumers prefer retailers' own brand products… but their claims concerning negative effects on consumer choice and prices are just plain bizarre!

The CIAA report claims retailers' own brands have various negative effects… "such as the effect on consumer choice and prices…" But how then to explain the average price differences between brands and retailers' own-brands for a sample of European countries [Kantar WORLDPANEL, Europanel 2009]. In Germany, the average prices of branded products were found to be 63% higher than retailers' own brands, in Spain even higher at 67%. The smallest price differences were found in the UK, but even there, the saving for consumers was an average of 33%! Admittedly these are great prices for consumers, not necessarily for food/drink competitors. But still, these effects don't look so 'negative'…

Also worth noting: In many cases grocery retailers research, develop, market-test and specify products before contracting out the production element to an industry partner.

{ For some balanced information on retailers' own brands, please read the Oxera Economic Consultants report – commissioned by ERRT – at www.errt.org/ownbrands }

WE LEAVE THE LAST WORD TO THE COMMISSION:

One of the key findings of the current exercise is that competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats. This has also translated into lower net operating margins for retailers (…) and has contributed to cheaper prices for consumers on the long term. Such findings seem to contradict wide-spread perception that retailers currently have the highest margins in the food supply chain.

[SEC(2009) 1449/2]

THE RETAIL SECTOR IS HAPPY AND WILLING TO DISCUSS HOW THE SUSTAINABLE COMPETITIVENESS OF THE WHOLE FOOD SUPPLY CHAIN CAN BE ENSURED; ALSO TO DISCUSS PROBLEMS AND CONTENTIOUS ISSUES, WHEN THEY ARISE.

HOWEVER, LET'S PLEASE MAKE SURE THE DISCUSSIONS ARE BASED ON FACT AND REALITY RATHER THAN ANECDOTE AND MYTH.

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